

# The Credit Union Director Handbook



## "The Director's Role: Reward and Responsibility"

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## **THE DIRECTOR'S ROLE: REWARD AND RESPONSIBILITY**

Service as a credit union director is an honor and can be quite rewarding in terms of helping one's fellow credit union members and the satisfaction one gets from a job well done. Unlike service on a bank or thrift board, credit union directors are typically volunteers that do not receive compensation. As volunteers, credit union directors face a lower level of potential liability exposure than directors of financial institutions that receive financial compensation for their services; however, the position bears serious responsibilities and the potential for personal civil and/or criminal liability. Directors are charged to make decisions and take actions that will produce a safe, sound, and profitable credit union.

For purposes of this handbook, assume there are two categories of directors: "outside" and "inside." Outside directors serve only as board members, while inside directors are active in running the day-to-day operations of the credit union. (These definitions are not to be confused with the use of the term "insiders" in law and regulatory issuances, which encompasses all directors and executive officers.) Inside directors could be held to an even higher standard due to their daily participation in the operation and management of the credit union.

The law fixes on the credit union's board of directors the responsibility of administering the business and affairs of this special enterprise for the benefit of the credit union members. Thus, persons serving as directors must have the ability, experience and integrity to direct affairs affecting the membership as a whole. Selection to serve as a director requires the individuals chosen to have reputations of being honest, prudent and successful in their own affairs, public-spirited, and entitled to confidence in the care of funds entrusted to the credit union by members.

The Georgia Financial Institutions Code (Code) declares that credit union directors must discharge their duties "in good faith and with the diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." This standard of performance has been required for years by Georgia courts. Failure to meet this legal responsibility subjects the credit union director to personal liability for any resulting losses to the credit union, its depositors or other creditors.

The presence of federal deposit insurance does not relieve a director of responsibility. When a credit union closes and the National Credit Union Administration (NCUA) makes payments of insured amounts to depositors, the NCUA, by law becomes subrogated to the rights and claims of the depositors against the credit union. These include any rights that may develop against directors of the credit union for losses that result from their failure to exercise the care and diligence required by law in the operation of the credit union. The NCUA may assert these rights when investigations covering a period of years prior to the closing indicate serious lapses in prudence, diligence and care on the part of directors.

The legal obligations of credit union directors are real, but not onerous. Directors are not liable for honest errors of judgement. If they act in good faith, directors may rely on financial information concerning the credit union represented to them to be correct by the credit union president, or the officer responsible for the credit union's books, or contained in a written report of an independent certified public accountant. Directors known to have possessed knowledge, which should have reasonably indicated the presence of troubling circumstances or "red flags", may be found to have been acting in bad faith by accepting certain information as representing actuality.

Directors must do their job in a prudent, competent, and responsible manner. Directors who foster a safe,

sound, and profitable financial institution need not fear regulatory actions or incurring personal liability. Liability is normally confined to cases where directors permitted repeated statutory violations or failed in regard to basic administrative duties or controls. It is to these matters that the remainder of this handbook is addressed.

## **SPECIFIC STATUTORY PROVISIONS**

### **Directors' Qualifications**

The Code requires that a credit union's directors be members of the credit union. Directors are elected annually at the annual meeting of the membership. The credit union's bylaws may provide for staggered elections for directors; but in this event the bylaws shall provide that approximately one-third of the board of directors shall be elected at each annual meeting.

Each director, as well as all committee members and officers of the credit union, must sign an oath pledging to diligently and honestly administer the affairs of the credit union and not knowingly or willingly permit violations of any of the laws applicable to credit unions or violate the bylaws of the credit union. A copy of this required oath should be kept with the minutes of the meetings of the board.

When a vacancy on the board of directors or credit committee occurs, it is the responsibility of the board to fill the vacant position until the election and qualification of a successor.

### **Directors' Meetings and Actions**

Georgia law requires credit union directors to meet as a board as often as necessary but at least once during ten different months of each calendar year. At the organizational meeting for new credit unions and at its first meeting after the annual members' meeting, the board is required to appoint a supervisory committee, chairman, president, secretary and such other officers consistent with the bylaws and needs of the credit union. The board of directors must also appoint a credit committee, or authorized loan officer(s) to consider loan requests from members. Where a credit committee is not established, loan officers, or in limited cases, the entire board of directors, must fulfill the responsibilities normally assigned to a credit committee. This does not preclude the appointment of both a credit committee and loan officer(s) to function in specific, complementary capacities as required by the Code and as stipulated by the board of directors. References below to the "credit committee" will apply to the loan officer(s) if a credit committee is not appointed by the board.

The chairperson of the credit and supervisory committees shall be a member of the board and appointed by the board. No member of the supervisory committee may serve as a member of the credit committee or as an officer. Both the credit and supervisory committees are accountable to the board with members subject to removal by the board. Officers serve at the pleasure of the board.

Unless reserved for the members in the bylaws, the board is charged with the following special duties:

1. Act upon all applications for membership;

2. Determine from time to time rates of interest and dividends which shall be paid on deposits and charged on loans consistent with applicable laws and to authorize any interest refunds on loans;
3. Fix the amount of the fidelity bond as prescribed by Department regulations to cover all officers, employees, agents, or members having custody of funds;
4. Fix within statutory restrictions the amount of deposits which may be made by and the maximum amount that may be loaned to any one member;
5. Invest funds of the credit union other than loans to members within statutory restrictions; and
6. Perform other duties as the members may authorize.

Following a regular program agenda can assist the board of directors in meeting their responsibilities. The program/agenda should include, but is not limited to:

- Reading and approving minutes of the preceding meeting;
- Receiving reports of committees and individual directors;
- Receiving reports of the credit union's condition with analysis and comparison with condition of previous dates;
- Receiving and/or reviewing reports on criticized loans identified by the credit union's internal loan review system, delinquent loans and other loans of which collection is doubtful, large loans, loans to directors and officers, and all loans made since the previous meeting;
- Reviewing securities transactions in the investment account;
- Receiving and/or reviewing a report and analysis of credit union expenses and income;
- Considering and taking action on reports of examination and correspondence from regulatory authorities;
- Analyzing adequacy of the allowance for loan losses; and
- Any other matters of importance,

Enough emphasis cannot be placed on the importance of directors' attendance and participation at board meetings and/or committee meetings. The effectiveness of even the most highly qualified of individuals can become questionable when attendance is infrequent or inconsistent. When individuals have commitments taking precedence over credit union activities, consideration should be given to asking that individual to resign in favor of others having schedules more compatible with the board or committee meeting schedules.

The board and all of its committees must maintain accurate and complete minutes of all meetings. A director who is present at a board meeting at which action on any corporate matter is taken is deemed to assent to the action unless his/her dissent is entered in the minutes. Alternatively, the director may file a dissent in writing with the secretary before adjournment of the meeting (assuming the director did not vote) or send it to the secretary by registered or certified mail within 24 hours after such adjournment.

## **Supervisory Committee**

Georgia law requires the supervisory committee to be responsible for securing a comprehensive audit of the credit union at least once each year. This may be accomplished by engaging the services of an independent accountant or firm of such accountants or the internal auditors of any sponsoring group, concern, or association of credit unions. The annual audit must be comprehensive in its scope, include confirmation of the share, deposit, and loan accounts of the members and cover the period elapsed from the previous audit.

The supervisory committee presents the results of the audit to the board and a summary of the audit results to the membership. With regard to the latter it is important that sensitive and confidential findings not be disclosed to the membership. Providing assurance to the members that a comprehensive audit was performed, along with a complete set of financial statements as of the audit date should be sufficient.

The supervisory committee is also responsible for making recommendations to the board for the correction of any deficiencies disclosed by the audit.

The annual audit report is preserved with the records of the credit union and a copy is filed with the department.

## **Credit Committee**

The Board of Directors must elect a credit committee, or in lieu thereof, appoint loan officer(s) to fulfill the responsibilities normally reserved for the credit committee. Those responsibilities, as discussed below, will apply to the loan officer(s) in those instances where the board has determined that loan officer(s), instead of a credit committee will be appointed.

The credit committee has statutory responsibility for the general supervision of all loans to members. The term "credit committee", unless otherwise noted, shall include, where applicable, board appointed loan officers who are named by the board in lieu of a credit committee, consistent with provisions in Code Section 7-1-658 of the Official Code of Georgia Annotated. If the board appoints loan officers in lieu of a credit committee, it shall establish policies for approval of loans by those loan officers. The credit committee may not appoint more than one of its members to be a loan officer. In carrying out its duties, the committee is to be guided by a loan policy established by the board of directors. The committee is required to hold meetings not less than quarterly to consider loan applications or as often as is needed to properly conduct business of the credit union. Credit committee actions are required to be reported to the board at each regular board meeting, in a manner prescribed by the board.

The credit committee may appoint one or more employees to be loan officers and delegate to such persons the power to approve or disapprove loans subject to such limitations or conditions as the credit committee prescribes. However, all loans in excess of 50% of a credit union's maximum loan limitation, or such lower limit as the credit committee may establish, shall be acted upon by the credit committee without delegation to a loan officer(s). In the absence of a credit committee, those loans must be acted upon by the board of directors. All loan approvals shall be maintained in a written form prescribed by the credit committee and available to the credit committee at all times. No loan should have proceeds disbursed unless the written approval is present.



## **Lending Restrictions**

Loans comprise the credit union's largest asset and generally contain the greatest risk of loss. One of the credit union directors' most important duties is to assure that the credit union's loans and other financing activities comply with statutory restrictions. Note that these statutory lending limitations are quite large for most credit unions, and the Board of Directors customarily establishes policy limitations for various types of secured and unsecured lending at lesser amounts.

These statutory restrictions formulate bounds of safety considered necessary for a credit union's sound operation. The following statutory lending restrictions apply:

1. Unsecured loans - For any individual borrower, not more than one percent of the first \$100,000 of the credit union's deposits and shares plus one-fourth of one percent of its deposits and shares over \$100,000.
2. Secured loans - For any individual borrower, not more than ten percent of the first \$100,000 of its deposits and shares plus four percent of the next \$1,000,000 of its deposits and shares plus 2% of its deposits and shares over \$1,100,000.
3. Combined loans - The maximum loan limit for the credit union for an individual borrower shall be the maximum amount allowed for secured loans including both secured and unsecured loans in the calculation.
4. Any credit union may make loans up to \$200 regardless of its total deposits and shares.

Please note for purposes of deposit and share calculation that deposits and shares reflected in the statement of condition on the last calendar day of the preceding quarter, to the nearest \$100,000, are used to establish loan limits for the subsequent calendar quarter. If a credit union has less than \$1,000,000 in total shares and deposits, the nearest \$1,000 is used to establish loan limits.

A borrower is defined as the member who actually received the proceeds from the loan. A member who endorses, guarantees, or cosigns a loan for another member is not considered the borrower. A secured loan is a loan for which adequate collateral is given. Collateral may include an endorser, guarantor, cosigner or similar obligor.

Credit Unions that offer share drafts are subject to the statutory limitation on loans secured by real estate. The general restriction is that not more than 75% of the fair market value of the underlying real estate can be loaned by a credit union in the case of a single maturity loan, and not more than 95% of the fair market value of the real estate in the case of loans that must be regularly amortized. Amortization requires that there will be a reduction of the principal of the debt during the life of the loan sufficient to repay the loan. Such reduction must occur at regular intervals and must amortize the loan over a period not to exceed 30 years. However, exceptions to the 40-year amortization schedule are made in the case of any mortgage contract which might result in negative amortization or extended repayment periods due to fluctuations in interest rates or to graduated payments, provided that the terms of the contract contemplate full amortization of the loan.

The National Credit Union Administration (NCUA) has established certain limitations on member business loans that limit the amount that a credit union can lend to business or commercial enterprises on an individual and aggregate basis. Credit unions making member business loans must comply with these

requirements.

### **Loans to Officers, Directors, Committee Members, and Employees**

Loans may be made to officers, directors, committee members, and employees of the credit union on the same general terms and conditions as to other members. No officer, director, committee member, or employee should participate in approving any loan in which he or she has a direct or indirect financial interest. Approval of such loans must be reported to the board at its next meeting. Such report, at a minimum, should include the name of borrower, terms (amount, interest rate and maturity) and collateral provided.

### **Allowance for Loan Losses, Statutory Reserves, and Other Reserves**

Because lending and investment activities are not risk free, the credit union's board of directors has a responsibility to establish adequate reserves for potential losses on loans and other contingencies that may arise. Both the Code and the National Credit Union Act require that adequate reserves against losses on loans and contingencies be set aside from gross earnings prior to the payment of dividends.

The allowance for loan losses represents reserves that are specifically designated to meet losses arising from lending activities. The allowance is created from periodic charges to income and from recoveries on prior loans that have been written off.

The board of directors should develop a sound methodology for assessing the adequacy of the allowance for loan losses based on the condition of the loan portfolio. The board must assess the adequacy of the allowance for loan loss account at least quarterly. The allowance account must be maintained at an adequate level as determined by the board of directors prior to the declaration of any dividends.

### **Investments**

No less than with loans, a credit union's investment policy is the responsibility of the board of directors, though authority for specific transactions may be delegated to an Investment Committee and officers in charge of investments. Every credit union should have a written investment policy agreed to and approved by the board of directors. Refer to the Department's "Guidelines for Policy Development" for recommendations concerning the content of the credit union's investment policies. This publication is available on the Department's website at: <http://dbf.georgia.gov/>

A credit union may hold investment securities in accordance with the Code and the Rules of the Department of Banking and Finance. The investment account represents excess funds not used for loans, cash reserves and fixed assets. A portion of the account should be designated as secondary reserves for investment in highly liquid securities that can be quickly turned into cash with minimum risk of market loss.

The remainder of the investment account can be placed in quality securities of longer, staggered maturities and higher yields. The maximum maturity is a matter to be determined and set forth in the investment policies of the board and will depend on a number of factors such as the amounts of cash reserves and secondary reserves normally carried, the degree of liquidity in the loan account, deposit structure, and yield requirements for paying interest on time and savings deposits to name some.

As a general rule, investments that cannot be clearly explained to the board of directors or for which directors cannot understand the investment strategy, source of investment return, or investment risk, should be avoided.

Investments in fixed assets are subject to statutory and regulatory provisions. A credit union may own real estate that it occupies or intends to occupy for the transaction of its business. Credit unions may also own real estate that is acquired for the purpose of providing parking facilities, facilities for data processing or other operational purposes. A credit union may also acquire and hold property to avoid loss on a loan, subject to certain Department approval requirements.

### **Shares, Deposits, and Third Party Payment Services**

The membership of a credit union is comprised of initial subscribers and other persons who have subscribed and paid for one share together with the required entrance fee and other bylaw requirements. No person may hold more than one share in a credit union with a minimum par value set by the board of directors (generally at \$5.00). Otherwise, the par value of a share is established in the credit union's bylaws. A share may be issued and deposits received jointly in the names of a member and a nonmember with right of survivorship, but no joint tenant shall be permitted to vote, obtain loans, or hold office unless he or she is within the field of membership and is a qualified member. Also, a share may be issued and deposits received in the name of a minor and in trust as the bylaws permit. Credit unions may also offer to its members, if its bylaws permit, "preferred capital base" shares subject to legal restrictions as prescribed by Section 7-1-652 of the Code.

In addition to regular savings deposits of members, the directors of a credit union may authorize issuance of deposit contracts in the form of member deposit certificates, where the credit union guarantees a rate of interest to the depositor which may be less than, equal to, or greater than savings accounts. The terms and conditions on these accounts are contained in Rule 80-2-3-.01 of the Department of Banking and Finance.

A credit union may offer, subject to prior approval from the Department, third party (share draft) payment services provided the credit union plan demonstrates:

1. A need currently exists among the membership;
2. The proposed plan will serve that need;
3. The proposed plan can favorably compete with other such plans offered by other financial institutions serving the needs of the members; and
4. The plan can be profitably implemented as determined by a three-year projection of the number of accounts, volume of transactions, and average aggregate balances in such accounts.

Credit unions that meet certain financial and managerial criteria specified by rule, regulation or policy will be exempt from the need for prior Department approval of third-party payment services, and would instead have to provide prior notice.

## **Dividends**

A competitive dividend rate should be paid on members' share deposits, member deposit certificates, and special classes of deposits to serve the membership, but not at a level that will endanger the survival of the credit union. While some accounts may carry a guaranteed rate or indexed rate, interest or dividends on basic savings accounts are determined by the profitability of the credit union. If the credit union is profitable the member/owners are rewarded commensurately through a dividend.

Where dividends and interest are in excess of the limitations prescribed by law or Department regulations, the prior written approval of the Department is required.

The Department's dividend approval process considers the following factors:

1. Adequacy of current year earnings to fund the proposed dividends;
2. Adequacy of reserves;
3. Adequacy of Undivided Earnings from previous fiscal years to maintain a reasonable dividend to shareholders for the next fiscal year;
4. Effects of any dividend reduction on cash flow and liquidity;
5. Competitiveness of dividend structure and deposit classifications; and
6. Asset condition of the credit union.

Payment periods for guaranteed rates for member deposit certificates and special classes of deposits are according to contracts but shall not be paid more frequently than monthly except for accrued dividends at time of redemption of the certificate or deposit. Regular savings accounts and non-guaranteed rates account dividends are to be paid not more frequently than monthly as prescribed by the board.

## **Supervisory Audits**

The supervisory committee may perform the annual audit, or more often the committee may contract with an independent auditor to perform this external audit. A specific responsibility of the supervisory committee is to confirm or have confirmed all share, deposit, and loan accounts of the credit union. In the event the credit union does not render members' statements at least annually, the Supervisory Committee or its designee shall confirm 100% of all member accounts annually. If all share, deposit, and loan statements are rendered to members either through the mail or hand delivered at least annually, the supervisory committee shall confirm or have confirmed 100% of all such accounts every two years.

All confirmations should be accomplished under the following controlled conditions:

1. All accounts shall be in balance with the general ledger prior to mailing or delivery;
2. The person normally responsible for posting member ledger accounts shall not participate in preparation or mailing of such statements of accounts; and

3. Confirmation shall contain notation on statement or an enclosure advising the member to notify the Chairman of the supervisory committee of any difference between the member's records and the credit union's records.

All conforming audits shall address the following areas to be acceptable to the Department:

1. Schedule of confirmations including method, percentages and follow-up procedures;
2. An evaluation of the credit union's system of internal routine and controls; and
3. A declaration of the general scope of the audit.

A sound audit program and a strong program of internal routine and controls are integral parts of a soundly operated credit union as well as a strong deterrent to fraud involving the assets of the credit union.

### **Surety Bond Coverage**

The board of directors is required to provide adequate surety bond coverage that provides for "faithful-performance-of-duty" coverage for any officer or employee while performing any of the duties of the treasurer as provided by the Georgia Code, the credit union bylaws, or the Department's rules and regulations. The board should review surety coverage annually for adequacy in relation to the credit union's exposure. The Commissioner may require additional surety coverage for any credit union that in his/her opinion, has insufficient coverage. If this occurs, the board shall obtain additional coverage within 30 days after being notified in writing of any deficiency.

In any case of misappropriation of funds, however small, the offending employee must be relieved of duty and the bonding company notified, whether claim for loss is made or not. A committee of the board or an independent third party should review Bond coverage periodically to determine that coverage is adequate and protects the credit union and its officers and directors.

# **A PROGRAM FOR CREDIT UNION DIRECTORS**

## **General Supervisory Duties**

The credit union's board of directors should act collectively in setting policies and in supervision of the active credit union management. The board cannot be expected to conduct the details of credit union daily operation, but the board is bound by law to know what goes on generally without impeding operating management in carrying out its duties.

Directors should direct and set the policies allowing operating management to execute the policies and carry out the details. The board derives its authority from the members and the bylaws; therefore, the directors should act as a board and not as individuals in carrying out such authority. The proper forum for this is at meetings of the board based on decisions made there by a majority and properly documented in the minutes of the board

## **The Individual Director**

A number of credit union directors, when first elected, may have little technical knowledge of credit unions and feel dependent on someone who does. This should lessen with experience and through study and attendance at any number of available seminars and training courses. Department personnel may always be consulted if there are questions or concerns.

It is incumbent upon the directors to become educated in credit union operations in order to effectively serve. The managing officers of the credit union must be supported and supervised by directors who are thoroughly familiar with the credit union's affairs and who will take an active part in making policies and decisions.

This helps to keep the credit union progressive, sound, and profitable.

Generally speaking:

1. Directors should have thorough knowledge of the duties and responsibilities of their office. Directors must take a pro-active approach in learning how to become competent in all areas requisite to effectively serve.
2. Directors should have a genuine interest in their office, attend all meetings regularly, and keep well-informed as to the affairs of their credit union at all times.
3. The director should be well known and respected in the sponsoring organization and with an unquestioned reputation for integrity.
4. Directors should give undivided loyalty to their office and not split loyalty with some interest adverse to the credit union.
5. Directors should possess the integrity not to use their office for personal benefits through information gained by virtue of their position.

6. Directors should be capable of retaining confidences and refrain from divulging confidential information gained through their position.
7. Directors should be successful individuals in their own right and leaders in the community as demonstrated by affiliation with such community projects as growth, development and civic affairs.
8. The director must be capable of recognizing facts as distinguished from prejudices or personal interest in reaching sound, independent decisions.
9. Directors should not lose sight of their primary responsibility, which is to protect the members and depositors who have placed their trust in them.

## **Board Reports**

The board of directors must have accurate and timely reports to adequately perform their responsibilities. Due to the increasing complexity of risk exposure in the financial services industry, it is important that directors understand and assess the possible impact of identified or potential risks to the credit union. To properly manage risk, directors and management must have the tools to accurately measure and monitor risk. Management must also understand the implications that those risks present and must ensure that appropriate safeguards are in place to minimize any negative impact on the credit union's capital and earnings.

To control risk and mitigate its impact on the credit union's financial performance, all credit unions must have risk management systems that identify, measure, control, and monitor risks. Strong risk management systems are particularly important when introducing new products or services or when the credit union experiences strong growth. Because market conditions and organizational structures vary, there is no single risk management system that works in all credit unions. Each credit union should tailor its risk program to its needs and circumstances. The board uses management reports and other information systems to stay informed and assess risk within an institution. Board decisions based upon ineffective, inaccurate, or incomplete reporting may increase risk within the credit union. The board must do more than merely accept and review management reports; it must be confident of their accuracy and reliability.

To be effective, directors should ensure that management provides adequate and timely financial data and other information that can answer questions such as:

- Is management meeting established goals and objectives?
- Are the credit union's strategic goals and objectives consistent with the directors' tolerance for risk?
- Does the credit union have sufficient capital to support its risk profile and business strategies?
- Is the level of earnings consistent or erratic?

- Do earnings result from the implementation of planned credit union strategies or from transactions that increase longer-term risk?
- Is the credit union being adequately compensated for the risks it is taking in its various product lines and activities?
- Are the reports accurate, or do they reflect an incomplete evaluation of the financial condition of the credit union?

The following risks are inherent in the management of a depository financial institution:

- Credit Risk – the risk of default on expected repayments of loans or investments and policies and procedures for collections.
- Interest Rate Risk – the risk that changes in market interest rates will negatively impact the income statement or balance sheet of the credit union.
- Liquidity Risk – the risk of an inability to fund the repayment of deposits and borrowings or meet lending obligations from available liquid assets.
- Transaction Risk – the risk of fraud or operational problems in transaction processing that results in an inability to deliver products, remain competitive and properly manage information and data.
- Compliance Risk – the risk of violations and non-compliance with applicable laws and regulations resulting in fines, penalties or damages.
- Strategic Risk – the risk of adverse business decisions through management actions or inactions that impact the competitiveness and viability of the credit union.
- Reputation Risk – the risk of negative public opinion or perception leading to a loss of confidence and/or severance of business relationships.

To assist the board in assessing risk, the following sections identify various indicators of increasing risk to include: asset and credit quality, liquidity, and interest rate risk that are generally a part of regular board reports. Other reports and performance measures outlined are useful to directors in assessing the credit union's current condition.

## **Board Committees**

To assist the board in directing the affairs of the credit union, it is necessary to have an active, functioning supervisory committee and a credit committee (or duly appointed loan officer{s}) to carry out specific duties of the board. Other committees should be established as the need arises.

A strong supervisory committee is a necessity for sound credit union operations since this committee has responsibility for conducting or having conducted an audit of the credit union. It is advisable to have a person on the supervisory committee with a strong accounting and financial background that is independent of active credit union management.



The credit committee (or loan officer{s}), as previously mentioned, has general supervision of all loans to members. Since lending to members is one of the primary purposes for the existence of the credit union, meetings of the credit committee should be frequent and contain well-documented minutes. The credit committee's report of loan activity to the board should be written, uniform, and occur each time the board meets.

## **Credit Union Policies**

The most effective tools any directorate can utilize in overseeing credit union operations are flexible, up-to-date, written policies. Written policies provide clarity of direction and continuity of thought. Periodic updating allows policies to evolve with changes in the credit union industry and keeps the policies flexible and usable. Regular violations of policies are key indicators that the operating officers are not implementing the board's wishes, or the policy is out of date and cannot be used efficiently in daily operations. In either case, board action is required to correct the situation.

### **Loan Policies**

Loan policies should provide a framework for the sound underwriting and collection of loans by the credit union. It should address all aspects of the credit union's lending program and be applied consistently by the loan officers and credit committee (or loan officer{s}) of the credit union.

The board, to insure a sound credit union, should formulate a written loan policy to include, at a minimum, the following areas:

1. A description of the types of loans and collateral considered desirable and the types of loans and collateral considered undesirable.
2. The responsibility of the directorate in reviewing and approving loans and periodically reviewing major lines of credit.
3. The lending authority of each loan officer.
4. The lending authority of the credit committee, if appointed.
5. The guidelines for unsecured credit.
6. The guidelines for rates of interest and terms of repayment for (a) secured loans and (b) unsecured loans.
7. Credit and collateral file documentary requirements for loans.
8. Limitations on the amount of secured loans that will be made in relation to the market value of the collateral or security pledged, and an identification of the type of supporting documentation required by the credit union for each type of secured loan.
9. Limitations regarding member business lending, if applicable.
10. Guidelines establishing limitations on the maximum volume of loans in relation to total deposits of the credit union.

11. A prohibition against (a) the addition of uncollected interest on the unpaid balance of any loan on which such interest is due; (b) the acceptance of a separate note for uncollected interest due on any loan unless supported by additional tangible collateral which adequately and completely secures the loan; (c) the continuation of accrual of interest on any loan delinquent 90 days or more; or (d) any other device that essentially avoids recognition of overdue loans and/or artificially inflates the income of the credit union. (This is not to imply forgiveness of such interest obligations to the credit union, but rather prohibits the credit union's recognition of the interest as income until its collection is assured.)
12. Credit union collection policies and procedures.
13. The guidelines under which uncollectible and past-due loans will be charged off.

The policy should provide specific procedures for policy exceptions, indicating how these are to be documented and approved.

### **Investment Policy**

The investment account represents funds available after deducting loans, cash reserves, and fixed assets. The investment policy should be written to cover, at a minimum, the following areas:

1. Legality - All investments should be legal under the Code of Georgia and/or Department regulations;
2. Quality - The policy should specify quality limits;
3. Maturity - The maturity schedule should take into account the credit union's economic and market situations as well as the asset liability management and liquidity position of the credit union;
4. Diversification - Diversification avoids unfavorable investment concentrations;
5. Marketability - The investment must be able to be sold through a ready market if cash is needed;
6. Income - Investments are earning assets and consideration should be given to yields, but yields should not cause the credit union to lose sight of other investment policy factors and objectives.

These are only some of the major areas to consider in establishing written investment policies. A complete investment policy is one that covers all the investment objectives established and updated for the individual credit union.

### **Other Policies**

The credit union should formulate other written policies including a liquidity policy, an asset-liability management policy and audit policy. Other policies may be needed depending on the complexity and scope of operations of the credit union, including a personnel policy, wire transfer policy, E-Banking or

Internet Banking Policies, Business Resumption/Disaster Recovery Policies and Procedures and other policies specific to the needs of the institution.

## **Personnel**

The directors elect the credit union manager, treasurer and other officers, but ordinarily delegate authority to the officers to select other personnel. These other employees are also accountable to the board. Therefore, the board should take an interest in the credit union's personnel.

In numerous embezzlement cases, it was discovered that the embezzler had been living beyond his or her financial means, had been speculating, had been leading an immoral lifestyle or had excessive business interests outside the credit union. These factors create financial problems for the credit union employee and can create losses for the credit union through potential embezzlement if the factors continue. Therefore, the board should encourage senior management to maintain open communications with employees and an awareness of the affairs influencing their actions.

The directors should see to it that the credit union pays salaries that compare favorably with those elsewhere in the area for similar kinds of work. The best people available should be employed and promotions should be on the basis of performance.

There should be a set policy for annual vacations for personnel. Credit union regulatory authorities recommend that each officer and employee be continuously absent from the credit union's premises for a minimum period of two consecutive weeks each year. Aside from the well being of the individual, this is also an important item in safeguarding against manipulation of customers' accounts or other credit union records. However, such safeguards fail if an employee's work remains for their return. In smaller credit unions, the limited number of employees may preclude two-week absences. In such cases, there should at least be a program of surprise rotation of duties and other compensating control measures in order to mitigate the risk of insider fraud and abuse.

Along with the other benefits of the establishment of a retirement plan, the plan generally includes the establishment of a normal retirement age for officers and employees. This has been a difficult and delicate matter in many credit unions with the result that some credit unions have continued under management that has passed the age of effectiveness.

While on the subject of retirement, directors should retire gracefully from active participation at a certain age (in accordance with established board policy) and make way for selection of active and vigorous successors. It is acceptable for retired members to continue their association by being designated "honorary director" or "advisory director," attending such board meetings as they wish, but having no vote and no legal liability.

Credit unions can greatly benefit by providing officers and employees training in credit union related schools. A well-trained staff offers the members better service and enhances credit union operating efficiency. The Georgia Credit Union Affiliates (GCUA) sponsors several of these educational programs. Visit the GCUA on the web at: <http://www.gcua.org/>.

In addition to in-house personnel, each credit union should consider retaining legal counsel. The legal environment in which credit unions operate is quite involved, and credit union management should have an established dialogue with professionals in these fields to assure that they maintain full awareness of

new laws and regulations and the potential impact on the credit union's operations. Credit unions are also becoming increasingly vulnerable to consumer legal action and should have legal counsel readily available to protect the rights of the credit union as an institution as well as the rights of the directors as they administer the affairs of the credit union.

### **Earnings and Expenses**

The board of the credit union should review monthly the credit union's income and expenses to insure the authenticity of income and expenses. These items should be in line with budgeted amounts and any significant departures from budget projections need explanation. Guidelines to govern employee travel and business expenses should be clear and reasonable.

Good earnings enable the credit union to operate on a sound basis, establish adequate statutory reserves, and pay members a fair rate on their deposits through dividends.

### **Capital Adequacy**

Credit Unions have only one method of enhancing or improving their capital position and that is through earnings retention. Credit Unions need to be mindful of their earnings performance and asset quality issues. Excessive volumes of loan charge-offs can result in rapid depletion of credit union capital. This issue has taken on increased urgency recently as Prompt Corrective Action provisions have recently been put into law for credit unions. These changes have made it vital for credit union Boards to monitor the capital positions of their credit unions, to make certain that these do not drop below a well-capitalized position. As capital declines, there are increasingly severe supervisory sanctions and if the capital falls too low, the credit union can be forced into involuntary merger or liquidation.

### **System of Internal Routine and Controls**

A sound system of internal routine and control is the credit union's primary protection against irregularities. Internal control can be described as a plan of organization and all of the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies. A system of control generally involves two types of controls - Accounting Controls and Administrative Controls.

- Accounting Controls comprise the plan of organization and all methods and procedures that are concerned mainly with and relate to (1) safeguarding its assets and (2) the reliability of the financial records.
- Administrative Controls comprise the plan of organization and all methods and procedures that are concerned with (1) operational efficiency and (2) adherence to managerial policies. They usually relate only indirectly to financial records.

A sound system of internal routine and controls should include: (1) a system or plan that provides for appropriate segregation of functional responsibilities; (2) an adequate system of authorization and record procedures that provides reasonable accounting control over assets, liabilities, revenues, and expenses; (3) sound practices to be followed in performance of duties and functions of each of the credit union's departments or business units; and, (4) a degree of quality of personnel commensurate with job

responsibilities.

The responsibility for the establishment of such a system of internal controls therefore rests with the directorate, with implementation by active management. The supervisory committee should take an active role in reviewing, or contracting for, a review of the internal controls system regularly. The board cannot delegate its ultimate responsibility of establishing a program of sound internal routine and controls to be followed.

## **Credit Union Reputation Risk**

Throughout this handbook, the importance of the board of directors' individual and collective involvement in the affairs of the credit union and the importance of sound, thoughtful policies in many areas of the credit union's operation have been discussed. Perhaps of equal importance, however, to the success of any financial institution has always been the reputation and public perception of the institution and those individuals associated with it, particularly the directors. In the early days of the credit union movement, these were all-important. Even with the advent of deposit insurance, fidelity bonds, pervasive regulation, and many other safeguards over the system, a good reputation and an image that gives the members of a credit union confidence in its management is critical. For this reason, this discussion cannot be concluded without a brief comment regarding this subject. Two particular areas deserve special note.

First to consider is the confidential nature of the affairs of the institution. Confidentiality in two respects should be maintained. The internal affairs of the institution must be protected from uninformed and partial review if the true condition is to be understood. Erroneous conclusions concerning the condition of a credit union can be drawn whenever full, accurate information is not available and such conclusions can initiate unfounded rumors that can damage not only the perception of the institution but lead to its financial demise through panic by its depositing members. Such external influences can also impair the ability of the directors and regulatory authorities to deal effectively with whatever problems that do, in fact, exist. Certain basic information is provided to the public and an additional level of information is made available to the members; however, it is the board of directors and the confidence that the membership has in those individuals that is the primary basis for each person's faith and trust in the credit union as a financial institution. Directors should stay informed concerning the affairs of the credit union but guarded in their discussion of those affairs outside of official meetings with the board, management, duly appointed auditors and attorneys, and regulatory authorities.

This reliance on and confidence in directors leads to the other area that should be considered here - individual financial responsibility displayed by directors and officers. The financial affairs of a director, committee member or officer must be above reproach. These Officials cannot be perceived as capable of handling the varied and frequently complex financial aspects of a credit union's operation when they cannot manage their own personal and financial affairs or when they engage in financial transactions with the credit union in a preferential and personally abusive manner. Further, it is not unusual for individuals to seek involvement in an official capacity with a credit union who have availed themselves of the bankruptcy process to avoid their just debts. Certainly, bankruptcy is a socially accepted way of reorganizing one's financial life and gaining a fresh start and may be the only solution when faced with large judgments or similar debts stemming from automobile accidents and similar unintentional acts creating liability.

Serving in a position of fiduciary and financial responsibility in a credit union is not typically appropriate for an individual that has acted in a fiscally irresponsible fashion. To ask credit union members to place

such a person in a position of trust and confidence in that financial institution is not a prudent action. Recognizing, however, that each individual case may have extenuating circumstances, there are no absolute prohibitions against service with a financial institution by such individuals. The full facts and circumstances of each individual case must be disclosed to the full board of directors and even the membership if required before they are asked to appoint the individual to an official position.

The regulatory agencies exercise an overview role in this regard and have the authority under statute to remove individuals who have not demonstrated the ability to conduct their financial affairs in a fiscally responsible manner and this prospect certainly should be fully discussed by the board and the candidate for appointment before action is taken.

The establishment of a formal, written policy governing the nomination process, including the appointment of a nominating committee to screen applicants for committee and director appointments is strongly recommended. This process provides an opportunity for review of the nominee's education, experience and financial history, including a review of the credit report, prior to consideration by the members (in the case of directors) and the directors (in the case of officers and committee members). Prescreening individuals wishing to serve assures that all candidates meet minimum acceptable standards before they are formally considered for election or appointment. Failure to perform such due diligence can result in unnecessary embarrassment resulting from subsequent removal or abrupt, unexplained resignation, after the appointment or election of an unqualified individual to a management position within the credit union.

### **Problem Credit Unions and Credit Union Failure**

While poor economic conditions make it more difficult for a credit union to sustain profitability, the policies and procedures adopted by the board of directors have a greater influence on whether a credit union will succeed or fail. Improperly functioning boards of directors and management have generally been the primary internal cause of problem and failed credit unions. The quality of a credit union's board and management depends on the experience, capability, judgment, and integrity of its directors and senior officers. Common oversight or management deficiencies identified in failed credit unions are listed below.

1. Uninformed or inattentive board of directors.
  - Nonexistent or poorly followed loan policies.
  - Inadequate systems to ensure compliance with policies or law.
  - Inadequate controls or supervision of key credit union officers or departments.
  - Inadequate problem identification systems.
  - Decisions made by one dominant individual.
  - Poor judgment in the decision-making process.
2. Negative influence from insiders.
  - Lack of policies or inadequate audits, controls, and systems.
  - Insiders of poor integrity.
3. Overly aggressive activity by board or management.
  - Liberal lending policies.
  - Excessive loan growth compared with management or staff abilities, cost systems, or funding sources.
  - Undue reliance on volatile liabilities.

- Inadequate liquid assets/secondary source of liquidity.
  - Out of territory lending
4. Other.
- Excessive credit exceptions.
  - Overlending.
  - Collateral-based lending and insufficient cash-flow analysis.
  - Unwarranted concentrations of credit.
  - Fraud and Insider Abuse

## **Responsibilities in the Examination/Supervision Process**

The Department is responsible for the overall regulation of the credit union. The Department reviews the credit union's performance through an on-going program of on-site examinations, as well as a program of off-site monitoring through call report information. The National Credit Union Administration (NCUA) Board, as insurer of member accounts, also has a vital interest in the stability and financial condition of the institution, and in certain instances, compliance with applicable federal law and regulations. The board of directors should review the report of examination to obtain an assessment of the credit union's financial and operating condition. The report of examination addresses the credit union's safety and soundness, the quantity of risk, the quality of risk management, and the level of supervisory concern. Directors should pay particular attention to weaknesses and adverse trends identified during an examination and to the actions management plans to take or has already taken to address those weaknesses. These topics are generally addressed in the "Examination Overview" and "Examiner Findings" sections of the report of examination.

## **CAMEL**

The Department as well as the NCUA uses the CAMEL rating system to assign composite and component ratings to a credit union. This system is a general framework for uniformly evaluating the safety and soundness of credit unions. A credit union's CAMEL composite rating integrates ratings in five component areas: the adequacy of capital (C), the quality of assets (A), the capability of management (M), the quality and level of earnings (E), and the adequacy of liquidity (L).

Composite and component ratings range from 1 to 5. A composite or component rating of 1 is the highest and best rating, indicating the strongest performance and the best risk management practices relative to the institution's size, complexity, and risk profile. A credit union rated 1 poses the least supervisory concern. A 5 rating is the lowest and worst rating, indicating the most critically deficient level of performance and inadequate risk management practices relative to the institution's size, complexity, and risk profile. A credit union rated 5 poses the greatest supervisory concern. The Department will provide these ratings to the board of directors after each examination. The board of directors should act promptly and in good faith to correct any material deficiencies that are identified in the examination process in order to prevent deterioration into a serious problem situation.

## **CONCLUSION**

Service as a credit union director can be a rewarding experience and a compliment to the primary business or professional pursuits of the individual; but, while it is an honor to be selected to serve as a director, the position carries a heavy responsibility and the potential for personal liability. A prudent

director acting in good faith and in keeping with the sound principles of credit union management as outlined herein need not fear the responsibility or liability. The Department of Banking and Finance, the Commissioner, the Deputy Commissioners, the District Directors, the Supervisory Managers, and the examiners who examine your credit union remain ready to discuss the duties and responsibilities of credit union directors and to assist in resolving any problems that may come to the attention of the director.